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Article

Tax Treatment of the PEPP: The New Pan-European Personal Pension Product

Bas Dieleman*

Regulation 2019/1238 concerning a pan-European personal pension product has entered into force on 14 August 2019. As a result, it becomes much easier for EU citizens to contribute to a personal pension product on a voluntary basis. It is expected that as from 2021, financial institutions are able to offer a pan-European personal pension product (PEPP) to EU citizens. The tax treatment of the PEPP is not included in the Regulation. However, ECJ case law on tax treatment of private pension products is applicable. In this article, the tax treatment of the PEPP is analysed. The focus of this article is on tax related aspects in case of contributions to a PEPP in one Member State, while receiving PEPP retirement benefits in another Member State. The article among other discusses granting tax incentives to the PEPP by Member States, taxation of PEPP retirement benefits in case a tax treaty is applicable and taxation in case the accumulated capital of a PEPP or the saver moves to another Member State.

Keywords: PEPP, pan-European personal pension product, pensions, retirement benefits, portability service, tax incentives, tax relief, tax treaties, exit tax

1 Introduction

Regulation 2019/1238 concerning a pan-European personal pension product (hereafter the Regulation) has entered into force on 14 August 2019.[1] As a result, it becomes much easier for EU citizens to contribute to a personal pension product on a voluntary basis. It is expected that as from 2021, financial institutions are able to offer a pan-European personal pension product (hereafter PEPP) to EU citizens. The tax treatment of the PEPP is not included in the Regulation. However, ECJ case law on tax treatment of private pension products is applicable.

In this article, I will analyse the tax treatment of the PEPP. The focus of this article is on tax related aspects in case of contributions to a PEPP in one Member State, while receiving PEPP retirement benefits in another Member State. The design of this article is as follows. Paragraph 2 discusses the background and main features of the PEPP. In paragraph 3, I will analyse if Member States shall grant tax incentives for contributions to a PEPP. In paragraph 4, I will discuss how PEPP retirement benefits will be taxed, especially in case a tax treaty is applicable. Paragraph 5 elaborates on taxation in case of a transfer of a PEPP to a provider in another Member State and paragraph 6 discusses exit taxes in case a saver moves to another Member State. Paragraph 7 contains the summary and conclusions of this article.

2 Background and main features

2.1 Background

The PEPP is the (European) Commission's response to its wish to supplement existing state pensions and occupational pension schemes. In most Member States, citizens hardly participate in (mandatory) occupational pension schemes, the second pillar pension. Only 27% of EU citizens between the ages of twenty-five and fifty-nine participates in an occupational pension scheme and within the EU there are a big differences between the participation rate of employees in occupational pension schemes.[2] From that point of view, the Commission's wish to introduce a pension product such as the PEPP is understandable. According to the Commission, the Regulation will contribute to the mobility of workers within the EU. Research on behalf of the Commission shows that all Member States already have a personal pension product (hereafter local personal pension product), but that the characteristics and the tax treatment of these products are vastly different.[3] In addition, the Commission states that the PEPP will lead to an additional accumulated pension capital of EUR 700 billion in the coming decade alone.[4]

In some Member States, for example the Netherlands and Finland, almost all employees participate in an occupational pension scheme. This implies that in those Member States

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1 Regulation (EU) 2019/1238 of the European Parliament and of the Council of 20 June 2019.

2 EC, factsheet: *A Pan-European Personal Pension Product* (26 June 2017).

3 EY, *Study on the feasibility of a European Personal Pension Framework* (June 2017.)

4 EC, *supra* n. 2.

and from an employee perspective, there appears to be limited demand for a new pension product. However, in for example Greece, Portugal and Spain, less than 10% of all employees participate in an occupational pension scheme.[5] In those Member States, a PEPP could improve retirement savings by employees significantly. The PEPP could especially be useful for young EU citizens who have more and more often a career in multiple Member States. [6] Furthermore, the PEPP could be attractive for the self-employed and other entrepreneurs, because these workers are generally not obliged to participate in an occupational pension scheme.

The Commission published the proposal for the Regulation in June 2017. The amended proposal was adopted by the European Parliament in June 2019. The Netherlands is the only Member State which has voted against the Regulation. This vote was the result of a motion from the Dutch House of Representatives. In this motion, the House of Representatives argued that pensions are matter of Member States and there is no need for pension related legislation on an European level.[7] Since the Regulation did not require an unanimous vote, the vote of the Netherlands against the Regulation did not really matter. According to the Regulation, the European Insurance and Occupational Pensions Authority (hereafter EIOPA) has until 15 August 2020 to develop regulatory standards, which are particularly related to the PEPP passport which will be discussed hereafter. Twelve months after the publication of these regulatory standards, which is next year, it is possible for providers to start offering a PEPP.

2.2 Main Features of the PEPP

According to Article 2 of the Regulation, a PEPP is an individual and voluntary pension product which is not an occupational pension scheme. This product has the explicit purpose of providing income on retirement. The aforementioned article implies that the PEPP is a third pillar product (hereafter a personal pension product).[8] Among others the Dutch government also views the PEPP as a personal pension product.[9] The Regulation does not harmonize or replace local personal pension products, but it harmonizes the so-called core features of a PEPP. If a personal pension product contains these core features, the provider of this product can request the competent authorities of a Member State to qualify as a PEPP. If this request is granted, the competent authorities of the Member State must inform EIOPA and EIOPA will then include the product in the public PEPP register which it shall develop. As mentioned in Consideration 28 of the Regulation, the registration in the PEPP register effectively results in a common PEPP passport.

As indicated above, a personal pension product must contain certain core features in order to qualify as a PEPP. Apart from obtaining a PEPP passport, the core features are distribution and provision of information, the investment policy, switching to another provider and cross-border supply and cross-border portability. Hereafter, I briefly elaborate on these core features.

With regard to distribution, Article 24 of the Regulation states all that information regarding the PEPP must be provided free of charge and electronically to the PEPP saver (hereafter saver). With regard to the provision of information, the PEPP Key Information Document as mentioned in Article 26 of the Regulation is particularly important. This document contains pre-contractual information regarding the PEPP and must be placed on the website of the PEPP provider (hereinafter the provider).

The Regulation includes various provisions regarding investment policy. Providers must invest in accordance with the prudent person rule. A provider is allowed to offer six investment options to the saver. For the option with the lowest investment risks, the so-called basic PEPP,[10] Article 45 of the Regulation states that the costs and fees to be charged, shall not exceed 1% of the accumulated capital. Providers could be reluctant of offer a PEPP because of this limit on costs and fees.[11]

For this article, the most important core feature of the PEPP is the portability service. As mentioned elsewhere,[12] this is the core feature which gives the PEPP a lot of added value compared to local personal pension products. Generally, local personal products do not have a portability service. According to Article 17 of the Regulation, the portability service implies that if a saver moves to another Member State, he or she has the right to continue to contribute to a PEPP. According to Article 18 of the Regulation, a provider must provide the portability service at the request of the saver. For example, if a resident of Spain contributes to a PEPP which is administered by a provider which is established in Spain, the provider will allow a continued contribution to the PEPP by the saver, after the saver has become a resident of France. As noted elsewhere, the portability service is also helpful in case there is a lack of trust in the financial sector in a certain Member State.[13] For the sake of completeness, I note that

5 OCED, *Pensions at Glance 2019*, figure 3.4.
6 PensionsEurope, *Position Paper on the Pan-European Personal Pension Product* (26 Jan. 2018).
7 Proceedings Dutch House of Representatives, 2017–2018, 21 501–07, no. 1435.
8 E. Lutjens, E. A. P. Schouten & M. C. W. Tomeij, *Reactie op 'De pensioen opPEPPer?'*, Tijdschrift Pensioenvraagstukken 2018/7, para. 2.
9 *Proceedings Dutch House of Representatives* (2017–2018), 22 112, 2432, at 16–17.
10 For more details, H. van Meeren & A. K. R. Wouters, *The PEPP Regulation; Pepper for the Capital Markets Union?*, Zeitschrift fur Verzicherungsrecht 2019/14.
11 G. Moss, *PEPP: Time to Get Personal*, IPE Magazine (Jan. 2020).
12 H. van Meerten & A. K. R. Wouters, *De PEPP-Verordening; quo vadis?*, Nederlands Tijdschrift voor Europees Recht, 2019-3/4.
13 M. Calu & C. Stanciu, *An Insight of the Future – Pan-European Pension Product*, semanticscholar.org (2018).

the Regulation does not require that a provider offers a PEPP that enable contributions by residents of all Member States as from the first day the product is available.

In order to ensure that a saver can continue to contribute to a PEPP regardless the Member State where he or she resides, Article 19 of the Regulation states that the PEPP has a sub-account for each applicable Member State. A sub-account is a national component of a PEPP, which component meets the legal requirements of personal pension products of a certain Member State. The idea behind the sub-accounts is that this should stimulate granting tax incentives to a PEPP, which will be discussed in paragraph 3.

Another core feature of the PEPP which is relevant for this article, is the switching service. According to Article 52 of the Regulation, the switching service gives a saver the right to have the accumulated capital transferred to another provider during the accumulation phase of the PEPP. This right, which arises five years after the conclusion of the PEPP agreement, also exists in case a saver wants to transfer his accumulated capital to a provider which is established in another Member State, even if the saver does not live in that state.

Offering a PEPP is possible for financial institutions as mentioned in Article 6 of the Regulation. In short, these are credit institutions, banks, investment institutions, insurers and pension funds, which are established in the EU. Upon request of the Netherlands,[14] the Regulation stipulates that pension funds cannot offer a PEPP if the legislation of the Member State concerned does not allow that pension funds offer personal pension products. As a result, pension funds are not allowed to offer a PEPP in some Member States, including the Netherlands.

3 Tax treatment during the accumulation phase

The Regulation does not include the tax treatment of the PEPP. The Commission has deliberately opted for this. Adjusting or harmonizing national tax regimes (for personal pension products) requires unanimous support from the Member States,[15] which is generally not feasible. This leaves the tax treatment of the PEPP to the Member States. However, this tax treatment is crucial to make the PEPP a success in the long term. As indicated in section 2.1, it appears that all Member States currently have at least one local personal pension product and that there are tax incentives for all of these products.[16] This observation is important because if there is no tax relief for contributions to a PEPP in a certain Member State, while there is tax relief for contributions to a local personal pension product, it is fair to assume that citizens choose the local product instead of the PEPP.

In order to encourage Member States to grant tax incentives to the PEPP, the Commission has issued a recommendation on the tax treatment of personal pension products.[17] In this recommendation, the Commission refers to the ECJ ruling in case C-422/01.[18] In this case, the ECJ has ruled that it is a violation of (currently) Article 56 TFEU, if an insurance policy concluded with an insurer established in another Member State, which insurance policy meets all the conditions for occupational pension insurance in national law except the condition that it has been concluded with an insurer established in the national territory, is treated less favourable for tax purposes compared to local insurance products. As mentioned elsewhere,[19] Member States are therefore in principle obliged to grant tax incentives to the PEPP, provided that the PEPP is properly designed.

Assuming that Member States grant tax incentives to a PEPP, it is unrealistic to expect that those tax incentives are more generous that tax incentives for local personal pension products. If this were the case, savers might try to move contributions which previously have been made to those local personal pension products. This will have a negative impact on local personal products.[20]

With regard to the aforementioned proper design of the PEPP, the sub-accounts referred to in paragraph 2 are of great importance. This allows a provider to adjust the features of a PEPP per sub-account to the conditions of tax relief for personal pension products applicable in a Member State. As a result, it is for example possible that a saver can contribute EUR 2,000 a year while living in Member State A, while he or she can contribute EUR 10,000 a year after moving to Member State B.

Since granting tax incentives to a PEPP is a matter of the Member States, the amount of tax relief as well as the conditions for obtaining tax relief, are expected to differ in each Member States. In for example the Netherlands, the government has confirmed that if a sub-account of a PEPP is designed in such a way that the conditions of Articles 3.124 to 3.127 of the Personal Income Tax Act 2001 are met, there will be tax relief for contributions to a PEPP. An important condition is that the annual contributions are in principle capped at EUR 12,986 (2020

[14] Proceedings Dutch Senate (2018–2019), 34,850, Letter of the Dutch Minister of Finance dated 18 June 2018.

[15] EC, *Explanatory Memorandum of the Proposal of the Regulation*, COM (2017)343, at 10.

[16] EY, *Study on the feasibility of a European Personal Pension Framework* 261 (June 2017).

[17] EC, *Commission Recommendation of 29 June 2017 on Tax Treatment of Personal Pension Products*, C(2017) 4393.

[18] ECJ 26 June 2003, Skandia and Ramstedt, C-422/01, ECLI:EU:C:2003:380.

[19] B. Dieleman, *Internationale fiscale aspecten van het PEPP*, Weekblad Fiscaal Recht 2020/10, para. 3.

[20] Arbeitsgemeinschaft fur betriebliche Altersverzorgung, position paper on the European Commission's Proposal for a Regulation on a pan-European Personal Pension Product (PEPP), 17 Oct. 2017.

figure).[21] Another important condition is that upon retirement, a saver cannot receive the accumulated capital as a lump sum payment. If the conditions of the aforementioned articles are met, the contributions for personal pension products are deductible for income tax purposes, while the corresponding retirement benefits are taxable. Furthermore, the accumulated capital is exempt from to taxation of wealth. As I have mentioned elsewhere,[22] providers established in the Netherlands as well as providers established in other Member States, should be able to meet all conditions as mentioned in the Articles 3.124 to 3.127 of the Personal Income Tax Act 2001. However, this could require significant administration costs.

4 Taxation of retirement benefits

As indicated in paragraph 3, Member States are in principle obliged to give the PEPP the same tax treatment as local pension products, provided that a sub-account of the PEPP is properly designed. Most Member States will have little objection to this obligation with regard to PEPP retirement benefits, because retirement benefits related to personal pension products are subject to tax in most Member States.[23] Regarding this matter it is relevant that based on ECJ case law,[24] if there is no tax relief for a PEPP during the accumulation phase, Member States are in principle required to exempt PEPP retirement benefits. As a result, it is in principle not possible that if there were no tax relief during the accumulation phase and the saver resides in a Member State during the payment of PEPP retirement benefits, that those retirement benefits are taxable. It is of course possible that the saver is residing outside the EU while receiving PEPP retirement benefits. If this is the case, the state of residence of the saver in principle will not have to take the aforementioned case law into account.

If the saver has contributed to a PEPP in several Member States or if the saver does not reside in the Member State of the provider, the question is which state or states are entitled to tax the PEPP retirement benefits. If the states concerned have concluded a bilateral tax treaty (hereafter tax treaty), the answer to this question is in principle included in this tax treaty. If no tax treaty applies, a saver will usually have to rely on legislation for the avoidance of double taxation of the Member State in which the saver is a resident.

If the pension related clauses of a tax treaty are in accordance with the OECD Model Tax Convention, PEPP retirement benefits will be taxed in the state of residence of the saver only. It does not matter whether the retirement benefits are paid as an annuity or as a lump sum. It is important to note that Article 18 of the OECD Model Tax Convention applies to occupational pensions only. As a result, Article 21 of the aforementioned convention is applicable to PEPP retirement benefits. As noted elsewhere,[25] it is important that if a tax treaty does provide for taxation in the state of residence of the saver only, while PEPP retirement benefits are subject to withholding tax in state of residence of the provider, the procedures to reclaim this withholding tax should be transparent and efficient.

The pension related provisions of tax treaties often deviate from the OECD Model Tax Convention. I will discuss the four most common deviations hereafter. The first common deviation (from the OECD Model Tax Convention) is that a tax treaty does not make a distinction between occupational pensions and personal pensions, which in practice means that the tax treaty contains one provision which covers both types of pensions. An example of a tax treaty with such a deviation is the tax treaty between Spain and Portugal. If this is the case, PEPP retirement benefits will be taxed in the state of residence of the saver only. In this case, it again does not matter whether the retirement benefits are paid as an annuity or as a lump sum.

The second common deviation is that the pension related provisions of a tax treaty (1) do not make a distinction between occupational pensions and personal pensions and (2) state that lump sum payments may also be taxed in the state of residence of the provider, if the state of residence of the provider has granted tax relief for the pension during the accumulation phase. An example of a tax treaty with such a deviation is the tax treaty between Italy and the Netherlands. In this case, PEPP retirement benefits which are paid as annuities are taxed in the state of residence of the saver only. However, PEPP retirement benefits which are paid as a lump sum, may also be taxed by the state of residence of the provider.

The third common deviation is that the pension related provisions of tax treaty (1) do not make a distinction between occupational pensions and personal pensions, (2) state that lump sum payments may also be taxed in the state of residence of the provider and (3) state that annuities may also be taxed in the state of residence of the provider if certain conditions are met. These conditions generally imply that the state of residence of the provider did provide tax relief during the accumulation phase of the pension and that the state of residence of the saver does not tax the retirement benefits. An example of a tax treaty with such a deviation is the tax treaty between Belgium and the Netherlands. In

[21] For more details, B. Dieleman & J. Post, *Fiscale aspecten van het nieuwe pan-Europees persoonlijk pensioenproduct*, Maandblad Belastingbeschouwingen 2019–10, para. 3.

[22] B. Dieleman, *Internationale fiscale aspecten van het PEPP*, Weekblad Fiscaal Recht 2020/10, para. 3.

[23] EY, *Study on the feasibility of a European Personal Pension Framework*, June 2017, table 1.

[24] ECJ 3 Oct. 2002, Danner, C-136/00.

[25] Irish Funds, *White Paper on the Pan-European Personal Pension Product* (June 2017).

this case, PEPP retirement benefits which are paid as annuities are taxed in the state of residence of the saver only, unless the national legislation of this state does not result in such taxation. Furthermore, PEPP retirement benefits which are paid as a lump sum, may also be taxed in the state of residence of the provider. As mentioned elsewhere,[26] the aforementioned deviation implies that Member States will not lose tax revenues in case they have granted tax relief to the PEPP in accumulation phase, while the saver resides in another (Member) State during the payment of retirement benefits. As a result, the PEPP is an additional incentive for Member States to renegotiate the pension related provisions of their tax treaties.

The fourth common deviation is that the pension related provisions of a tax treaty (1) do not make a distinction between occupational pensions and personal pensions, (2) state that lump sum payments may also be taxed in the state of residence of the provider and (3) state that annuities may also be taxed in the state of residence of the provider, but that such a taxation may not exceed 15% or 20% of the annuities. An example of a tax treaty with such a deviation is the tax treaty between Finland and Estonia. In this case, PEPP retirement benefits which are paid as annuities, may be taxed in the state of residence of the saver as well as the state of residence of the provider. Furthermore, PEPP retirement benefits which are paid as a lump sum, may be taxed in the state of residence of the saver as well.

5 Tax issues of the switching service

As indicated in paragraph 2, one of the core features of the PEPP is the switching service, which gives a saver the right to have the accumulated capital transferred to another provider during the accumulation phase of the PEPP. In the case of a switch between two providers which are established in the same Member State, it is in my opinion unlikely that significant tax issues arise. In this case, there are for example no incentives for Member States to tax the accumulated capital upon a switch of provider. However, such tax issues are likely to occur in case of switch to a provider which is established in another Member State. In this case, a Member State could for example tax the accumulated capital upon the switch of provider in order to reclaim the tax relief which has been granted during the accumulation phase of the PEPP. For example, in the Netherlands, Article 3.133 of the Personal Income Tax Act 2001 states that in the event of such a switch, the tax relief which is granted in the accumulation phase of a personal pension product is in principle fully reversed. In addition, an additional 20% interest is due. Taking into account the top rate from Dutch personal income tax, the accumulated capital is taxed at 69.5% in the year of the switch. As noted elsewhere,[27] such tax rates imply that no reasonable saver will exercise the right to transfer the PEPP to a provider established in another Member State.

One could claim that if a Member State taxes the accumulated capital of a PEPP upon a switch to a provider which is established in another Member State, while the accumulated capital is not subject to tax in case of a switch between two providers which are established in the same Member State, there is a violation of the TFEU. Such a claim could for example be supported by the recent decision of the Commission to send a reasoned opinion related to the Dutch tax legislation on the transfer of occupational pensions to other Member States.[28] However, one could also argue that because of the portability of the PEPP, there is no significant obstacle for savers to move to another Member State from a personal pensions perspective. As mentioned in paragraph 2, the portability enables that savers who move to another Member State, can continue to contribute to a PEPP which is administered by a certain provider, while using a sub-account of the PEPP.

6 Exit taxes

At the beginning of the century, the ECJ has already decided that exit taxes by a Member State in case of unrealized capital gains of an EU citizen moving to another Member State, are a violation of the TFEU.[29] Furthermore, the ECJ has decided that a preservative tax assessment which effectively postpones an exit tax for capital gains until the aforementioned gains have been realized, are a violation of the TFEU, if the conditions of the postponement of the exit tax are too difficult to meet.[30] The Supreme Court of the Netherlands has decided that the aforementioned ECJ case law is also applicable to preservative tax assessments for pensions.[31]

Considering the aforementioned case law, it is hard to imagine that if a saver has obtained tax relief for a PEPP in a certain Member State and the saver moves to another Member State, the Member State which has granted the tax relief, levies an exit tax related to the PEPP which needs to be paid immediately. However, it is still possible that in case a saver has obtained tax relief for a PEPP in a certain Member State and the saver moves to another Member State, the Member State which has granted the tax relief will issue a preservative

[26] P. Kavelaars, *Fiscale onevenwichtigheden*, Tijdschrift voor Pensioenvraagstukken, 2017/33.

[27] B. Dieleman, *Internationale fiscale aspecten van het PEPP*, Weekblad Fiscaal Recht 2020/10, para. 5.

[28] EC 27 Nov. 2019, Nov. infringement package, https://ec.europa.eu/commission/presscorner/detail/en/inf_19_6304.

[29] For example, ECJ 14 Mar. 2004, case C-9/02 (Hughes de Lasteyrie du Saillant).

[30] ECJ 7 Sept. 2006, case C-470/04 (N).

[31] Dutch Supreme Court 15 Apr. 2011, case no. ECLI:NL:HR:2011:BN8728.

tax assessment which postpones an exit tax for the accumulated capital of a PEPP as long as certain conditions are met. If for example a saver would obtain tax relief for a PEPP while residing in the Netherlands, the Netherlands will issue such a preservative tax assessment based on Article 3.136 of the Personal Income Tax Act 2001. This preservative tax assessment will for example result in an exit tax which has to be paid immediately, if the PEPP retirement benefits are paid as a lump sum.

7 Summary and conclusions

In this article, I have analysed the tax treatment of the PEPP. The PEPP is the pan-European personal pension product which is introduced by Regulation 2019/1238. It is expected that providers can start offering a PEPP to EU citizens as from 2021. An important feature of the PEPP is the portability. As a result of the portability service, providers shall upon request arrange that if a saver moves to another Member State, the saver can continue to contribute to the PEPP through a sub-account. Another important feature of the PEPP is the switching service. The switching service gives the saver the right to transfer the accumulated capital of a PEPP to a provider, regardless the state of residence of the saver or the provider. The tax treatment of the PEPP is not included in the Regulation. However, based on ECJ case law, it can be concluded that Member States are in principle obliged to grant tax incentives to the PEPP, if a sub-account is designed properly.

The taxation of PEPP retirement benefits is straightforward if the saver continues to live in the state of residence of the provider. The taxation of PEPP retirement benefits is generally covered by tax treaties in case the saver has contributed to PEPP while residing in several Member States or if the saver does not reside in the state of residence of the provider. The pension related provisions of tax treaties frequently deviate from the OECD Model Tax Convention. In this article, I have discussed the most frequent deviations as well the outcome of these deviations on the taxation of PEPP retirement benefits. Furthermore, it has been concluded that taxation upon transferring the accumulated capital of a PEPP to a provider in another Member State is possible. If such taxation is expected, it is unlikely that savers will opt for the switching service of a PEPP. Finally, it is concluded that based on ECJ case law, it is hard to imagine that if a saver has obtained tax relief for the PEPP in a certain Member State and the saver moves to another Member State, the Member State which has granted the tax relief levies an exit tax which needs to be paid immediately.